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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9709]

RIN 1545-BK64

Application for Recognition as a 501(c)(29) Organization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations authorizing the IRS to prescribe the procedures by which certain entities may apply to the IRS for recognition of exemption from Federal income tax. These regulations affect qualified nonprofit health insurance issuers participating in the Consumer Operated and Oriented Plan program established by the Centers for Medicare and Medicaid Services that seek exemption from federal income tax under the Internal Revenue Code.

DATES: Effective date: These regulations are effective on **[INSERT DATE OF PUBLICATION]**.

Applicability date: For date of applicability, see §1.501(c)(29)-1(c).

FOR FURTHER INFORMATION CONTACT: Martin Schäffer, (202) 317-5800 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 501(c)(29) of the Internal Revenue Code (Code) provides requirements for tax exemption under section 501(a) for qualified nonprofit health insurance issuers (QNHIs). Section 501(c)(29) was added to the Code by section 1322(h)(1) of the Patient Protection and Affordable Care Act, Public Law 111-148 (March 23, 2010) (Affordable Care Act).

Section 1322 of the Affordable Care Act directs the Centers for Medicare and Medicaid Services (CMS) to establish the Consumer Operated and Oriented Plan (CO-OP) program. The purpose of the CO-OP program is to foster the creation of member-governed QNHIs that will operate with a strong consumer focus and offer qualified health plans in the individual and small group markets. CMS provides loans and repayable grants (collectively, loans) to organizations applying to become QNHIs to help cover start-up costs and meet any solvency requirements in States in which the organization is licensed to issue qualified health plans. For each loan, CMS issues a Notice of Award and Loan Agreement to the QNHII. The appropriate officer of the QNHII or of the QNHII's board of directors must sign and return the loan agreement to CMS. On December 13, 2011, CMS issued final regulations implementing the CO-OP program at 76 FR 77392.

The CMS final regulations define a QNHII as an entity that, within specified time frames, satisfies or can reasonably be expected to satisfy the standards in section 1322(c) of the Affordable Care Act and in the CMS final regulations. The entity will constitute a QNHII until such time as CMS determines the entity does not satisfy or cannot reasonably be expected to satisfy these standards. Section 1322(c) of the Affordable Care Act imposes a number of requirements, including that a QNHII be

organized as a nonprofit member corporation under State law and that substantially all its activities consist of the issuance of qualified health plans in the individual and small group markets in each State in which it is licensed to issue such plans.

Section 501(c)(29)(A) of the Code provides that a QNHII (within the meaning of section 1322(c) of the Affordable Care Act) which has received a loan or grant under the CO-OP program may be recognized as exempt from taxation under section 501(a), but only for periods for which the organization is in compliance with the requirements of section 1322 of the Affordable Care Act and any loan or grant agreement with the Secretary of Health and Human Services. Section 501(c)(29)(B) provides that a QNHII will not qualify for tax-exemption unless it meets four additional requirements. First, the QNHII must give notice to the Secretary of the Treasury, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of exemption as an organization described in section 501(c)(29). Second, no part of the QNHII's net earnings may inure to the benefit of any private shareholder or individual, except to the extent permitted by section 1322(c)(4) of the Affordable Care Act (which requires that any profits be used to lower premiums, to improve benefits, or for other programs intended to improve the quality of health care delivered to the organization's members). Third, no substantial part of the QNHII's activities may consist of carrying on propaganda, or otherwise attempting, to influence legislation. Finally, the QNHII may not participate in or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office. As required by section 1322(b)(2)(C)(iii) of the Affordable Care Act, CMS must notify the IRS of any determination of a failure to comply with the CO-OP program standards,

including any loan agreement, that may affect a QNHII's tax-exempt status under section 501(c)(29) of the Code.

Section 6033 requires a QNHII to file an annual information return. Section 6033(m), added to the Code by section 1322(h)(2) of the Affordable Care Act, further requires a QNHII to provide additional information on the amount of reserves required by each state in which the QNHII is licensed to issue qualified health plans and the amount of reserves on hand. These requirements are met by filing a Form 990 for each tax year in which the QNHII claims tax-exempt status, including tax years prior to receipt of a determination letter from the IRS recognizing its tax-exempt status. See Notice 2011-23, §8, 2011-13 IRB 588, as well as Instructions for Form 990-EZ, "Short Form Return of Organization Exempt from Income Tax."

On February 7, 2012, temporary regulations (TD 9574) authorizing the IRS to prescribe the procedures by which certain entities may apply to the IRS for recognition of exemption from Federal income tax were published in the **Federal Register** (77 FR 6005). On the same date, and under the authority of the temporary regulations, the IRS issued Rev. Proc. 2012-11, 2012-7 IRB 368, providing instructions on how an organization should apply for recognition of exemption as an organization described in section 501(c)(29). The IRS intends to reissue Rev. Proc. 2012-11 (with a 2015 designation) under the authority of the final regulations.

A notice of proposed rulemaking (REG-135071-11) cross-referencing the temporary regulations was also published in the **Federal Register** on February 7, 2012 (77 FR 6027). No public hearing was requested or held. Two comments responding to the notice of proposed rulemaking were received and are available at

www.regulations.gov (Docket Number IRS-2012-0007). After consideration of the two comments, the proposed regulations are adopted without revision, and the corresponding temporary regulations are removed.

Summary of Comments and Explanation of Provisions

Section 501(c)(29)(B)(i) of the Code provides that a QNHII which has received a loan through the CO-OP program established under the Affordable Care Act by the Centers for Medicare and Medicaid Services may be recognized as exempt from taxation under section 501(a) only if, among other things, the QNHII gives notice to the IRS, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition as an organization described in section 501(c)(29). These final regulations provide that the Commissioner has the authority to prescribe the application procedures that a QNHII seeking such recognition must follow. These final regulations expressly authorize the Commissioner to recognize a QNHII as exempt effective as of a date prior to the date of its application, provided that the application is submitted in the manner and within the time prescribed by the Commissioner and that the QNHII's prior purposes and activities were consistent with the requirements for exempt status under section 501(c)(29).

Neither of the comments received addressed the proposed rule authorizing the IRS to prescribe the procedures by which certain entities may apply for recognition of exemption from Federal income tax as organizations described in section 501(c)(29). One commenter suggested that the final rule clarify that the failure of a QNHII to meet the requirements of state insurance laws may be grounds for the denial or revocation of the entity's tax-exempt status. In addition, the commenter suggested that the

application for a section 501(c)(29) determination letter, as described in Rev. Proc. 2012-11, should include an affirmation by the entity seeking an exemption that it meets all applicable state requirements for a qualified health insurer, including solvency and licensing standards.

The final regulations do not incorporate these suggestions. Section 501(c)(29)(A) provides for recognition of a QNHII that has received a loan or grant under the CO-OP program for periods for which the organization is in compliance with the requirements of the Affordable Care Act and of any CO-OP program loan or grant. An entity that CMS has determined qualifies as a QNHII remains a QNHII until CMS determines that it does not satisfy or cannot reasonably be expected to satisfy the standards in section 1322(c) of the Affordable Care Act and the CMS final regulations. CMS must notify the IRS if a QNHII fails to comply with the CO-OP program standards, including any loan agreement. If CMS determines that an organization no longer qualifies as a QNHII, it will lose its tax-exempt status under section 501(c)(29) of the Code. Because the commenter's suggestions relate to an organization's qualification as a QNHII, rather than to the requirements for a QNHII to be recognized as tax-exempt, these suggestions were not adopted.

Another commenter recommended that the final rule make it clear that all state and federal laws and regulations that currently apply to 501(c) organizations – including those related to transparency, reporting, and the treatment of assets upon dissolution – apply also to organizations recognized under section 501(c)(29), noting particularly the requirement to file a Form 990, "Return of Organization Exempt From Income Tax," and related documents on an annual basis. The commenter further recommended that the

final rule specifically address aspects of the Affordable Care Act that are not within the jurisdiction of the Treasury Department.

The final regulations do not incorporate these suggestions. With respect to the Code, different requirements apply to different types of organizations described in section 501(c). Section 501(c)(29)(B) sets forth the conditions that a QNHII must satisfy for exemption from Federal income tax. Section 6033 and the regulations thereunder generally requires all organizations exempt from taxation under section 501(a), including QNHIIIs exempt under section 501(c)(29), to file Form 990, unless an organization qualifies for an exception from the filing requirement. With respect to section 1322 of Affordable Care Act, CMS issued final regulations in December 2011 implementing the CO-OP program and providing the basic standards that an organization must meet to be a QNHII and participate in the program. Those requirements are outside the jurisdiction of the Treasury Department. For these reasons no additional regulatory guidance is needed.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has been determined, also, that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply, and because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Code, the NPRM preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its

impact on small business.

Drafting Information

The principal author of these regulations is Martin Schäffer of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), although other persons in the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.501(c)(29)-1 also issued under 26 U.S.C. 501(c)(29)(B)(i). * * *

Par. 2. Section 1.501(c)(29)-1 is added to read as follows:

§1.501(c)(29)-1 CO-OP Health Insurance Issuers.

(a) Organizations must notify the Commissioner that they are applying for recognition of section 501(c)(29) status. An organization will not be treated as described in section 501(c)(29) unless the organization has given notice to the Commissioner that it is applying for recognition as an organization described in section 501(c)(29) in the manner prescribed by the Commissioner in published guidance.

(b) Effective date of recognition of section 501(c)(29) status. An organization

may be recognized as an organization described in section 501(c)(29) as of a date prior to the date of the notice required by paragraph (a) of this section if the notice is given in the manner and within the time prescribed by the Commissioner and the organization's purposes and activities prior to giving such notice were consistent with the requirements for exempt status under section 501(c)(29). However, an organization may not be recognized as an organization described in section 501(c)(29) before the later of its formation or March 23, 2010.

(c) Effective/applicability date. Paragraphs (a) and (b) of this section are applicable beginning February 7, 2012.

§ 1.501(c)(29)-1T [Removed]

Par. 3. Section 1.501(c)(29)-1T is removed.

John Dalrymple

Deputy Commissioner for Services and Enforcement.

Approved: January 22, 2015

Mark J. Mazur

Assistant Secretary of the Treasury.

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